

Labour regulation and employment growth

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One of the major failures of the neoliberal economic strategy in India over the past fifteen years has been inadequate employment generation. Yet the obvious lessons from this experience - that obsessively contractionary macroeconomic policies and forms of technology choice encouraged by economic openness have been responsible - are not drawn by those in charge of policy making. Instead, the poor performance of organised sector employment in particular is blamed on excessive "protection" to workers in that sector, which supposedly prevent employers from taking on more workers.

So the argument is made that investment has been constrained, and employment growth has been insufficient, because of rigidities in the labour markets that adversely affect employers' sentiments particularly as regards organised sector activities. Three types of regulation are seen as especially constraining for employers in the Indian context: first, fairly stringent rules relating to firing workers and also for closing down enterprises, along with requirements of reasonable compensation for retrenchment; second, laws governing the use of temporary or casual labour which enforce permanence of contract after a specified time of employment; third, minimum wage legislation which raises the cost of hiring workers.

Like so much else in the policy debate in India, these arguments do not really stem from the Indian context directly, but are lifted more or less completely from other - western - contexts. In particular, the argument is made that labour market rigidity (arising from protective labour laws and unemployment benefits) has been responsible for high unemployment rates in western Europe - contributing to what has been called "Eurosclerosis". Meanwhile, "flexible" labour rules allowing for workers to be fired easily have supposedly meant lower unemployment rates in the United States. This has become the new orthodoxy, so much so that it is the received wisdom being imparted to everyone across the world who is concerned with the issue of unemployment.

But in fact, even in the developed world, this particular argument has little theoretical justification and even no empirical basis. A recent book edited by David Howell (*Fighting unemployment: The limits of free market orthodoxy*, Oxford University Press 2005) blows the lid off the myths and exposes the argument as fundamental misconception.

The articles in this book provide a critical assessment of the free market orthodoxy that deregulating labour markets is necessary to promote more employment generation in developed countries. They clearly establish that there is no simple trade-off between unemployment and wage inequality or reduced worker protection. In fact, it turns out that the justification of fighting unemployment that is regularly used to invoke measure to dismantle the welfare state, are based more on ideology than on experience.

The book includes both cross-country studies covering all the major developed countries, as well as individual country case studies covering countries not only the US and Britain, but also high unemployment cases like Spain and "success stories" of reducing unemployment such as Ireland, New Zealand and the Netherlands. A consistent message of the articles in the book is that there is no simple explanation of the high unemployment prevalent in the OCED countries.

Nor is there one path to reducing unemployment which necessarily involves more labour market deregulation. The evidence simply does not support the free market view that convergence to the US model - by reducing wages, increasing inequality and ensuring greater economic insecurity for workers - is the only path to good employment performance. This is established through both negative examples where the US model has been imitated without mitigating unemployment, and positive examples where strong welfare state provisions have been associated with falling unemployment.

For example, Canada over the 1990s implemented wide ranging deregulation of the labour market aimed at greater "flexibility" along US lines, in response to high unemployment in the 1980s. This certainly increased labour flexibility according to all standard indicators, such as causing more labour shifting across sectors and geographical regions, greater hiring and firing in response to demand conditions, and so on. This certainly led to greater flux and turbulence for workers, more job insecurity and replacement of workers' collective bargaining

with individual dependence upon private contractors, with much less bargaining power.

Yet, despite all this, Canada's employment performance - measured not only by unemployment but by worker participation rates and employment generation - was even worse than before. So Canada experienced the worst of both worlds during the 1990s: weak macroeconomic conditions, reduced labour market intervention and weaker social policies, producing both falling employment and rising inequality.

At the other end of the spectrum, the "high road" examples are provided by Denmark and Sweden, two countries that exemplify the universalistic welfare state, with strong labour market regulation and high standards of labour regulation. If these are disincentives to employment generation, then these countries should have experienced higher unemployment than elsewhere. Yet in both countries, while unemployment rates have varied, they have generally performed better than the US with its much worse levels of worker protection.

In fact, the improved employment generation of recent years in Scandinavia has made the region the best performer in this regard among all the OECD countries. More significantly, it has been achieved without sacrificing the basic elements of the Scandinavian model: high tax rates, a comprehensive social security system, universal unemployment insurance benefits, and the lowest levels of wage and income inequality in the world.

It can be concluded from the range of studies presented in this book that preventing falling wages, reducing high earning inequalities and not allowing excessive job insecurities actually requires strong labour market policies and institutions, and these are not at all incompatible with low unemployment rates. All this has tremendous policy implications for most developed countries, where the less skilled workers have borne the brunt of weak aggregate demand, large economic and demographic shifts and labour market deregulation.

But the implications for developing countries like India may be equally important. If the urge to greater "competitiveness" is not to depend upon constantly increasing worker insecurity in a desperate race to the bottom, but only sustainable increases in aggregate worker productivity, it is important to improve labour market regulation and protection to all workers, rather than undermine them further.